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Correspondent of The National City Bank of New York

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THE NATIONAL CITY BANK OF NEW YORK

1927

Economic Conditions
Governmental Finance
United States Securities

New York, May, 1927

General Business Conditions

THE general business situation continues to justify all reasonable forecasts made of it at the beginning of the year. Not all developments have been satisfactory, but the balance of influential factors continues to be of favorable character. Easter trade has been good where weather conditions have permitted, and bank debits and railway traffic have indicated distribution generally to be in large volume. Steel production in March set a new high record, and April promises to show up as another active month even though not up to the level of March. The cotton goods branch of the textile industry is doing the best business in years, tire manufacturers have had a big first quarter, and most of the motor companies, have enjoyed a good volume of sales.

That business generally looks forward to the maintenance of activity during the current quarter is indicated by the estimates of car requirements submitted to the railroads by shippers' advisory committees in different parts of the country which anticipate a commodity movement in most lines equaling or slightly exceeding that of a year ago.

Among unfavorable factors in the present situation may be listed the bituminous coal strike, which has now been in progress a month, but has caused little inconvenience to general business thus far, owing to heavy stocks on hand and large production from non-union mines. Production is off about 40 per cent since the strike, but this comparison is with a period of abnormally high operations, present mining being only 14 per cent under last year at this time and above the rate in 1925 and 1924. As a matter of fact, demand is too slack to absorb even the present output, which is down partly because of slow consumer buying.

Devastating floods have wrought destruction over a large section of the lower Mississippi Valley and caused a reduction of purchasing power which will be felt in the primary markets of the country. Aid is being brought to the stricken territories, however, and extensive as the damage has been the business of the country rests on too broad a base to be seriously affected thereby. Meantime cotton prices, which have been strengthening slowly on improved consumption outlook, have risen sharply above 15 cents, on prospects that the flood may result in a considerable reduction in acreage.

One of the most significant developments of the month was the publication of figures on building contracts awarded in March, which were the highest for any month on record, surpassing those of March last year by 4 per cent. One would be rash to conclude from this that building is headed for new records every month, such an eventuality being neither probable nor desirable, but the conclusion at least is justified that building is in for no sudden or drastic decline. In view of the importance of construction activities in the general business situation, indication of continued support from this quarter is decidedly reassuring.

The Trend of Corporation Earnings

Business earnings statements now coming out for the first quarter make a mixed showing, with slightly over half of the companies reporting gains as compared with a year ago. Of the steel companies, United States Steel gained slightly, but earnings of most other companies were less satisfactory, due to the somewhat slow start of the industry on the new year and the lower prices quoted for steel products. Returns from the automobile industry were varied. While some of the oil companies did fairly well during the first quarter, the effect on others of over-production and price cutting was marked.

Narrower margins of profit, coupled with the increase of business failures during recent months, are indications of tendencies at work in business of which account must be taken. According to recent Government tables, prices of industrial materials, as result of recent declines, are now at lowest levels since the war. Capacity in many lines to produce in excess of market requirements is resulting in a

growing intensity of competition which is placing increasing pressure on the weaker and less efficient units of industry. It is manifesting itself not only in the smaller profits in some lines and a higher failure record, but also in more frequent mergers and the increased tendency for industries to seek a solution of their common problems through some form of cooperative action such as is exemplified by the recently formed Cotton Textile Institute. In the absence of any seriously disturbing symptoms in the business outlook, however, and with credit supplies continuing ample, we do not see any reason why needed adjustments should not go forward in a normal manner, at the same time affording ample opportunity to up-to-date well managed concerns for continued good business.

The elimination of concerns unable to sustain themselves against the competition of more progressive rivals always has been going on, but with more rapid development in the technique of industry, greater incentives to mass production, and increased supplies of capital at the command of successful enterprises; the movement inevitably is speeded up.

Money and Banking

The money market has moved along on an even keel during April, continuing the unusual stability displayed since the first of the year. Following the seasonal easing in January, call loan rates have held almost steadily at 4 per cent, showing neither the customary advance in February and March nor the usual decline in April. Bill rates have been almost unvarying 3¾-3⅝ per cent for 90-day acceptances, and time money and commercial paper rates have likewise been little changed. The latter eased slightly in February, recovering in March to present levels of 4 to 4¼ per cent for prime names.

Steadiness in money during recent months, ironing out the usual seasonal tendencies, apparently reflects the combined effect of gold imports, active commercial demands, a strong stock market, and circumstances arising out of recent Government financing. During the early months of the year gold was flowing into the market in large volume, which had the effect of preventing the usual seasonal firming in money in February and March. Later, by April, when the effect of these gold additions had spent itself in a rising volume of bank credit outstanding, the result has been for money to again reverse the seasonal tendency.

Since the middle of February loans of reporting member banks have increased by $192,000,000 of which $97,000,000 has been in loans secured by stocks and bonds and $95,000,000 in all other loans, representing largely commercial transactions. On top of this increase member banks, spurred on by their eagerness for Government deposits, subscribed heavily to the new offering of Treasury securities on March 15, anticipating the usual redistribution of a part of these securities to the public, which, however, did not materialize in the expected volume owing to the close rate put upon them by the Treasury. The banks, as a result, found themselves under the necessity of limiting somewhat their advances in other directions or of increasing their borrowings at the Reserve banks, thus resulting in the modification of seasonal tendencies already described.

The Bank of England Rate

Reduction by the Bank of England of its rediscount rate from 5 to 4½ per cent was an outstanding event of the month which has led to much speculation as to what effect it would have on the New York Federal reserve rate. Action by the Bank of England had been foreshadowed by recent changes in the London money market. Sterling has been gradually strengthening its position since the first of the year, while the Bank of England has recently been able to add substantially to its gold holdings, these gains in gold being accompanied by an easing of open market rates in London. With the sweeping reductions that have occurred in the leading continental markets since the beginning of the year, the time has seemed opportune for relieving business and commercial interests in England from the pressure of a relatively high bank rate and at the same time permitting the Government to ease their budget situation by making possible the sale of Treasury bills at lower rates.

The Situation in This Country

The situation in this country, however, is of a different character. The present rate of 4 per cent is already low and there is no reason to believe that business would benefit by a further reduction. It will be recalled that at the time of the reduction to 3½ per cent made almost precisely a year ago, the stock market had just undergone a drastic liquidation and there were indications of considerable nervousness on the part of business as to the future. In the present picture, stock speculation has been active, with prices, until recently, at peak, largely as result of the already easy money conditions, and the market is absorbing considerably more credit than a year ago. On April 20 brokers' loans, as reported by the Federal reserve banks, stood at $2,878,000,000, the highest point of the year and $413,000,000 above the total on the corresponding date of last year. The total volume of member bank commercial loans, moreover, stands at a high level, $186,000,000 above a year ago at this time, notwithstanding the lower level of commodity prices, while bank portfolios of investment securities have also largely expanded,

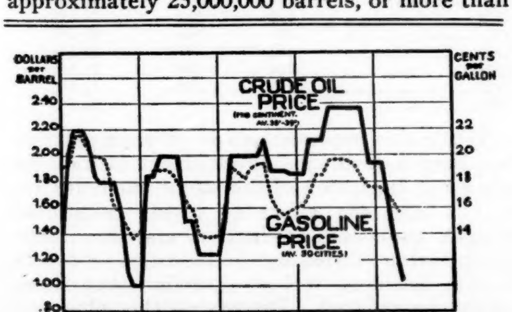
due partly to recent acquisitions of Government securities as described in foregoing paragraphs. Under these conditions there seems real danger that a reduction in the bank rate would be taken as an encouragement to excessive speculation. The rise of the gold holdings of the country to new high levels as result of recent gold imports, with the potentialities this gives of further credit expansion, emphasizes the responsibilities which bankers have to see that these great reserves do not become a menace to our economic stability.

The Money Outlook

So far as the immediate future in money is concerned the outlook seems to be for continued stability of rates. Call loan rates may vary somewhat from the present average, but commercial rates generally should show comparatively little change. With large gold reserves on tap and the volume of Reserve bank credit outstanding down to a billion dollars there seems little reason to anticipate any change upward. Nor should rates go materially lower, so long as business holds up to the present mark and barring heavy liquidation in the security markets or further gold imports. While some uncertainty has existed as to whether the reduction of the British bank rate might not cause a movement of funds to New York, thus affecting the market here, the steadiness of sterling since the British rate reduction and last week's gain in gold by the Bank of England indicates that no important shifting of balances has thus far materialized.

Overproduction in Oil

The oil industry continues to contend with serious overproduction. Output of crude remains below the peak of 2,486,350 barrels reached in the week of February 26, but is running close to 2,480,000 barrels daily, and with the single foregoing exception is at record levels. As this production is considerably in excess of current consumption, large amounts of oil have had to be added to storage. During the first quarter of the year stocks of all products are estimated to have increased by approximately 25,000,000 barrels, or more than

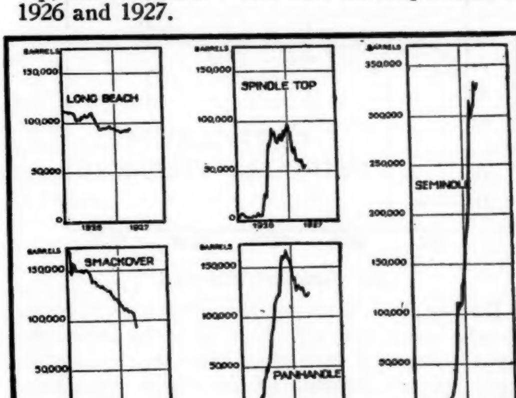


the reduction accomplished in 1926, and the increase is continuing at the rate of some 250,000 barrels daily. Reflecting this heavy surplus of oil, prices both of crude oil and gasoline, have been cut drastically.

The preceding diagram, comparing prices of mid-continent crude and tank wagon gasoline prices at 50 cities illustrates graphically how deeply these cuts have gone.

Largest single factor in present flush production has been the heavy yield in the Seminole-Earlsboro area. Since last Summer this pool has climbed to a daily average production of around 334,000 barrels, a very high figure, though still well below the phenomenal record of 445,000 barrels daily reached by Smackover in 1925. It should be remembered, however, that the Smackover oil was a low gravity oil, yielding a low percentage of gasoline. It could be run out into open pits and easily stored with relatively little loss through evaporation. The reverse is true of the Seminole oil, which contains a high percentage of gasoline and must be refined immediately or stored in closed tanks to prevent heavy evaporation. This difference renders the present overproduction more acute.

Following is a diagram comparing average daily production of each of the five leading pools during the period from January 1926 to date. Of these five pools Smackover and Long Beach reflect a continuation of activities begun in previous years, while Panhandle, Spindletop, and Seminole were new developments of 1926 and 1927.

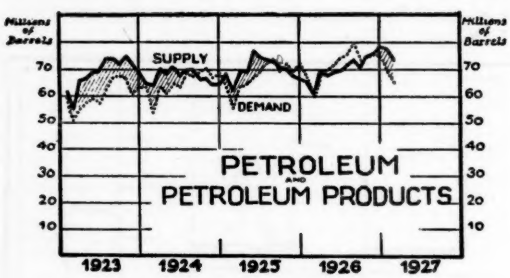


Improved Conditions in 1926

Coming when the production of other leading pools was on the decline, Seminole has been the immediate cause of another of those sudden reversals of trend characteristic of the oil industry. For several years prior to 1926, production of oil almost continuously exceeded consumption, and, barring seasonal reductions, stocks increased steadily until they reached a record grand total of approximately 550,000,000

barrels in the latter part of 1925. With the decline of Smackover production, however, in the latter part of 1925 and early in 1926, the situation began to turn for the better. Domestic production during the first part of 1926 dropped well below that of 1925 and did not get above again until along in August. Imports were also lower, having been declining steadily for several years, due to the falling off in Mexican production, which amounted to only 90,700,000 barrels in 1926 when compared with 193,398,000 barrels in 1921. In the face of this easier supply situation, demand continued to increase rapidly, due to increased consumption in the automobile industry and widening use in industry generally. By the middle of the year it was running definitely ahead of current production, stocks were showing the first real reduction since 1920, and there was even some talk of a possible oil shortage within a few years. Prices advanced and it began to look as though the long deferred prosperity in the oil industry was at hand.

The next diagram, comparing total oil demand and supply figures by months since 1923, as computed by the United States Bureau of Mines, reflects these changing relations between production and consumption during recent years, and indicates the improved statistical position in 1926. (Figures include crude and refined oils, and imports and exports as well as domestic production and consumption.)



The Situation Reversed

During 1927, however, the situation has completely reversed itself. Instead of the improvement witnessed last year, the industry again faces an oil surplus of indefinite duration. Higher prices stimulated renewed drilling activity, and more wells were sunk in 1926 than in any previous year since 1920 with results now familiar to all.

Attempts on the part of operators in the Seminole field this Spring to come to some agreement to control excess production were unsuccessful, and the situation there, as elsewhere, has been left to work itself out in accordance with the ordinary laws of supply and demand. In the end the lower prices will bring about a decline in production by discouraging new drilling operations, but in the meantime there is no assurance that output may not continue for some time around present levels, or even go higher. Some companies which are in a position to do so have taken steps to curtail production, but most of them are unable to do this without danger of having their oil drained off through neighboring sections. Companies, moreover, which have wells under way or have leased land under contract to drill wells must in most cases carry them to completion.

Were Seminole the only disturbing element in the present situation, the outlook would be more reassuring. Unfortunately, however, there is no certainty that the pressure of overproduction will end with Seminole. Activity in the search of oil has revealed reserves in west and southwest Texas which are much larger than any the industry has had in sight at any previous time in its history. These reserves await only a recovery in oil prices and means of transportation to be brought into production.

Influence of the Cracking Process

No consideration of the relationship between supply and demand in the oil industry is complete without reference to the increasing efficiency of the cracking process by which a constantly growing amount of gasoline is being obtained from a given amount of crude. The first yield of gasoline from crude is obtained by ordinary distilling, and cracking consists in breaking up the fuel oil residue under high temperature and pressure into further parts of gasoline. The process has been steadily improved until the yield of gasoline from crude oil over a ten-year period has been increased from 21 per cent in 1917 to 34.7 per cent in 1926, and is still rising.

(MILLIONS OF BARRELS)

Year	Crude Oil Runs to Stills	Gasoline Produced from Crude Oil	% Gasoline Production to Crude Runs to Stills
1917	315	66	21.0%
1918	326	83	25.5%
1919	362	91	25.1%
1920	434	113	26.0%
1921	443	120	27.1%
1922	501	144	28.7%
1923	581	175	30.1%
1924	644	200	31.1%
1925	740	239	32.3%
1926	783	272	34.7%

While this improvement in refining practice has been a fortunate development in view of the great expansion of the motor car industry, it has also the effect of giving additional weight to crude production and the large stocks being carried by the industry. Leaders in the business feel it essential that these stocks be reduced. Discussing this phase of the situation, W. C. Teagle, President of the

Standard Oil Company of New Jersey, recently said:

These stocks of some 530,000,000 barrels should be reduced, regardless of the fact that for the most part the oil in storage cost more money than current production. It is estimated that, adding the yearly cost of carrying these stocks to the price as originally paid, the average cost of oil now in storage is about $2.30 per barrel. It is a great economic mistake to regard this oil as locked away until new production is selling for as high a figure.

The industry should forget the accumulated charges on oil carried for several years, and should use these stocks to make up any deficiency in current supply. In the long run, the producer will be much better off if he suspends drilling projects that do not have to be carried through within a given time, until a very substantial draft has been made upon our reserves in storage.

The industry is meeting an annual bill of around $130,000,000 for the privilege of carrying these stocks above ground. There is less need of large reserves now than was the case a few years back, because of the greatly increased amount of gasoline represented by each barrel of crude now in storage. The cracking process, operating on stocks that were formerly considered of value only as fuel, has in effect doubled the yield of gasoline which can be obtained from a barrel of oil. For this reason, it is to be hoped that the industry will weigh very carefully the questions of current demand and production set off against reserve stocks above ground.

Oil Industry Too Competitive

Clearly the difficulties from which the industry is suffering are to a large extent the result of the intense and destructive competition that prevails within it. In the face of constant evidences of this competition it is hard to see how the notion can persist with so many people that oil companies have it much their own way in determining market conditions. Only recently we have had an example of this competition in the inability of the Seminole operators to agree on some concerted action for curbing the mounting overproduction in that field. As a matter of fact in few industries are the workings of the law of supply and demand more uncontrollable than in oil.

Almost anyone can go into the oil business, and anyone of the great number in it, by a lucky strike that locates a big well, may exert far-reaching influences on the industry. When oil is discovered in any given area there is a rush to exploit that area to its utmost before the oil is drained off by some one else. Thus much oil that should stay in the ground is brought to the surface to add to the already unwieldy stocks in storage. Such competition is neither good for the industry nor for the public, which is interested in the conservation of our oil resources.

Undoubtedly a greater degree of centralization or at least of cooperation in the industry would help, but this is difficult to obtain under existing conditions, and our petroleum laws, unfortunately, are such as to increase rather than diminish these difficulties. That some liberalization of these laws is needed was recognized by the Federal Oil Conservation Board appointed by President Coolidge to study the oil situation. In its report rendered last year this Board recommended certain changes in the law affecting cooperative agreements which, if adopted, would be an important step towards establishing the industry on a more stable basis.

The Bond Market

The continuance of a heavy investment demand which was further strengthened by an inflow of new funds from heavy April dividend and interest disbursements forced the bond market during the month into new high territory. The changing character of investment buying indicates that many of those investors who have hesitated to invest because the market seemed high are rapidly coming to a realization that their ideas of interest return must be readjusted to meet the prevailing market. A few months ago the major portion of new offerings of high grade rails and other bonds of similar quality were absorbed in the larger investment centers, but present offerings of such securities are bringing subscriptions from all over the country and from a class of much smaller investors than heretofore.

The Dow Jones average for 40 listed domestic corporate issues, (10 high grade rails, 10 second grade rails, 10 industrials and 10 public utilities) again broke through its previous post-war record. On April 25th the average stood at 97.33 as compared with the high point for the month of 97.49 and with 95.09 on April 23rd a year ago. On March 25th the average was 97.16. With the level of interest yields now substantially lower than for many years, corporations and other borrowers have not been slow to take advantage of the opportunity to refund their outstanding higher rate issues where such could be done advantageously. During the month of April corporate issues called in advance of maturity totaled $192,282,000, which according to the Dow Jones compilations is a new high record. The previous high record for any single month occurred in July, 1922, when $144,799,000 were called. The Chile Copper Company retired on April 1st all outstanding $35,000,000 Convertible 6s at 110 and sold 5 per cent Debentures in their stead. Nearly half of the $45,000,000 of Georgia Power Company 5s were issued to retire outstanding issues of the older company. Another extensive refunding operation was that of the Aluminum Company of America, which paid off its 7 per cent obligations from the proceeds of a 5 per cent issue.

United States Government Bonds

Although showing slightly reactionary tendencies earlier in the month, the United States Government bond market was generally firm, due to the easing money tendencies. There was good buying at advancing prices in long term Treasury 3¾s, 4s and 4¼s and in longer term Liberty issues.

One of the largest refunding operations of the year was the offering on April 4th of $100,000,000 Federal Land Bank 4¼s to yield 4.10 per cent, about $92,800,000 of the proceeds of which were used to retire outstanding Federal Land Bank 4½s at par. Although an issue of this character would seem to have its greatest appeal with large investors, estates and institutions subject to the heavier income taxes, reports from dealers indicate a broad distribution among investors of all classes, many people of more modest means apparently being willing to accept the lower yield because of the attractive security which such bonds offer. These bonds are obligations of the Federal Land Banks and each issue is secured by collateral consisting of an equal amount of farm mortgages issued under the provisions of the Federal Farm Loan Act.

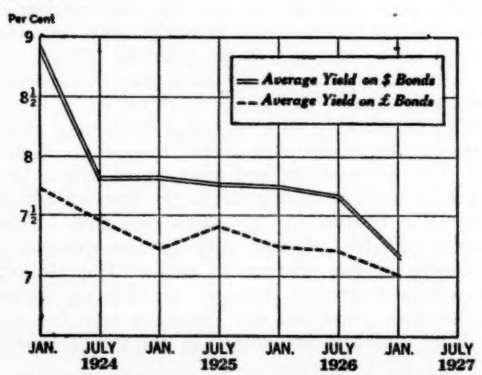
Municipals

The municipal bond market continued to move aggressively forward under the stimulus of the general bond market advance. Factors making for continued firmness in this group include a restricted volume of new offerings and the prospect of increasing demand with the release of large volumes of investors' funds through United States Treasury operations. The municipal price advance, although aggressive, has apparently not kept pace with the forward movement of the high grade issues in other groups. The level of municipal prices at present is almost exactly at the level of 1917, while the bond averages generally have gone well above this figure. Atchison 4s, for instance, recently sold at their highest price in twenty -years. Highest grade municipals on the other hand are now selling on about a 3.90 per cent basis as compared with a 3.75 per cent basis twenty years ago. Municipal issues now also show investors an advantage of 13½ per cent tax exemption for corporations and as high as 25 per cent for individuals. The fact that this tax exemption has never been adequately reflected in the municipal market is probably due to the retarding influence of a flood of municipal financing since the war. With municipal financing today at more normal levels the market apparently is in a position to adjust itself more closely to the prevailing average for other groups.

Foreign

Although the financial crisis in Japan produced temporary liquidation and unsettlement in the Japanese government and municipal issues, the market for foreign bonds generally during the month was strong with Italian and German industrial issues leading the advance. A sensational rise in Italian Public Utility and Credit Institute 7s was one of the outstanding features. These bonds advanced several points on reports that the bonds would be called. German General Electric Debenture 6½s with warrants rose to a new high of 132 and Rhinelbe 7s with warrants to a new high of 126¾. All French bonds were higher as were also Polish issues in anticipation of new Polish government financing. The two leading new foreign offerings during the month were a $30,000,000 issue for the City of Milan and a $25,000,000 issue for New South Wales. The City of Milan 6½s were offered at 92 as compared with a price of 91 for the City of Rome 6½s offered in the latter part of March.

Yields among domestic issues have declined to such an extent that only in the foreign field can investors now secure a rate of return at all comparable with the rates prevailing on domestic issues a few years ago. The growing popularity of foreign dollar bonds is evident not only in the more widespread distribution of such securities during recent years but also in the rapidly shrinking differential between the London and New York yields on foreign bonds outstanding in both markets. Until a year or so ago the London portions of international loans almost invariably sold at higher prices (lower yields) than prevailed in New York because British investors were more inclined to judge securities on their intrinsic merits. This situation is now rapidly changing as is evident on the chart below showing the yield trend in London and New York on several well known issues. The shrinkage in the yield differential from about 1.20 per cent on January 1st, 1924 to 0.17 per cent on January 1st, 1927 is largely the result of a developing world viewpoint among American investors.



Trend lines show the comparative average yield on the London and New York portions of the following loans:

Dollar Bonds	Sterling Bonds
Czechoslovak 8s of 1951	Czechoslovak 8s of 1951
Japanese 6½s of 1954	Japanese 6s of 1959
Paris, Lyons and Mediterranean 6s of 1958	Paris, Lyons and Mediterranean 6s of 1958
Department of the Seine 7s of 1942	Department of the Seine 7s of 1952
Austrian 7s of 1943	Austrian 6s of 1943

Among the principal new issues, both for-

eign and domestic, offered during the month, were the following:

$8,809,000. Atlantic Coast Line R. R. Gen. Unif. Series "A" 4½s, due June 1, 1964, price 98 and interest, to yield over 4.60 per cent.

7,000,000. State of New York Serial 4s, due annually September 1, 1933, to September 1, 1976, incl., offered at prices to yield 3.65 per cent.

30,000,000. Kingdom of the Serbs, Croats and Slovenes (Jugo-Slavia) Sec. Ext. Series "B" 7s, due May 1, 1962, price 92½ and interest, to yield over 7.60 per cent.

100,000,000. Federal Land Bank 10 to 30 year 4¼s, due May 1, 1957, optional May 1, 1937, price 101¼ and interest, to yield about 4.10 per cent.

7,000,000. Cincinnati Street Railway Co. 1st Series "A" 5½s, due April 15, 1952, price 100 and interest.

30,000,000. City of Milan, Italy, Ext. S. F. 6½s, loan of 1927, due April 1, 1952, price 92 and interest, to yield 7.19 per cent.

25,000,000. State of New South Wales, Commonwealth of Australia, Ext. S. F. 5s, due April 1, 1958, price 96¼ and interest, to yield 5.25 per cent.

13,000,000. Spruce Falls Power & Paper Co., Ltd., 1st 5½s, due $500,000 each April 1 and October 1, 1930, to April 1, 1943, incl., price 100 and interest.

55,000,000. Duquesne Light Co., 1st 4½s, due April 1, 1967, price 95 and interest, to yield 4.78 per cent.

9,400,000. Empire District Electric Co., 1st & Ref. 5s, due March 1, 1952, price 98½ and interest, to yield over 5.10 per cent.

50,000,000. Shell Union Oil Corp. 20 year S. F. Deb. 5s, due May 1, 1947, price 99½ and interest, to yield 5.04 per cent.

20,000,000. United Cigar Stores Co. of America 6 per cent Cumulative Preferred Stock, price $109 per share and accrued dividends.

17,350,000. Illinois Central R. R. Co. and Chicago, St. Louis & New Orleans R. R. Co. Joint 1st Ref. Series "C" 4½s, due Dec. 1, 1963, price 97½ and interest, to yield 4.64 per cent.

12,000,000. State Mortgage Bank of Jugo-Slavia Sec. S. F. 7s, due April 1, 1957, price 92 and interest, to yield 7.69 per cent.

10,000,000. American Radiator Company 20 year Deb. 4½s, due May 1, 1947, price 96 and interest, to yield over 4.80 per cent.

15,000,000. Canadian National Railways Equip. Tr. Series "J" 4½s, due $1,000,000 each May 1, 1928 to 1942, incl., offered at prices to yield 4.50 per cent to 4.70 per cent, according to maturity.

21,200,000. Argentine Government Ext. S. F. 6s, Public works Issue of May 1, 1927, due May 1, 1961, price 99 and interest, to yield over 6.05 per cent.

10,750,000. Meridionale Electric Co. 30 year 1st Mtge. Series "A" S. F. 7s, due April 1, 1957, price 95½ and interest, to yield over 7.35 per cent.

The Financial Disturbance in Japan

The past month has witnessed the outbreak of a serious financial disturbance in Japan. Confidence of the Japanese public in the banks was temporarily shaken, resulting in runs on many institutions throughout the country, and forcing numerous suspensions of which the most prominent was that of the Bank of Taiwan, of Formosa, which operates a large number of branches throughout Japan and in foreign countries. The Fifteenth Bank of Tokio was another important bank that was forced to close, in addition to which some thirty or so small banks have gone under. So acute did the situation become that the Government on April 22 declared a moratorium for three weeks.

The immediate causes of these difficulties were (1) the failure of Suzuki & Company, a large Japanese concern carrying on operations in many lines of industry and trade, both in Japan and other countries, and (2) the rejection by the Privy Council of the Government's plan for extending aid to the Bank of Taiwan, to which Suzuki & Company was indebted for very large sums. The more fundamental causes, however, date back to the earthquake of 1923, the deflation of 1920, and to the very rapid development of Japanese industry and trade over many years. This development has tended to keep the capital resources of the country fully employed and under the pressure of ever-growing demands, with the result that business credit has been employed without sufficient reserves to deal with emergencies.

Present Difficulties an Aftermath of 1920

When the great slump of that year took place the Japanese financial authorities adopted a moderate policy towards those who were in trouble and unable to meet their obligations, in the hope that by this course liquidation might be accomplished gradually and with the least disturbance to general business. As a result of this policy some of the banks even as late as 1923 were carrying large amounts of frozen credits, and among those most heavily involved were the Bank of Taiwan and the Fifteenth Bank.

The general economic situation in Japan, however, was recovering and yen exchange by August, 1923, just prior to the earthquake, was getting back close to par. The Government was considering the early removal of the embargo on gold exports, and it is possible that had it not been for the earthquake the policy of gradual liquidation might have worked out successfully.

The Earthquake

The earthquake, however, changed the situation entirely. Banks which were still carrying the old debts were unable to liquidate them, and in addition were called upon to carry new burdens. The Government stepped in to help at this juncture and on September 27, 1923, passed a law known as the Government Compensation Act in Connection with Earthquake Losses, in which it was provided that banks holding paper arising out of earthquake losses might pass this paper on the Bank of Japan and the Government agreed to indemnify the Bank of Japan up to 100,000,000 yen (approximately $50,000,000) for any loss

incurred by it through the rediscounting of such bills.

The Situation Again Tided Over

Once more, therefore, the situation was tided over temporarily in the hope that liquidation could be spread out gradually over a long period. In support of its policy, the Government adopted stringent measures in all directions to minimize payments abroad and to improve the foreign trade balance. Approximately $454,540,000 was borrowed in foreign markets to meet obligations abroad and pay costs of reconstruction. In 1924 $175,000,000 of 4½ per cent bonds held abroad fell due and were paid off. Though the balance of merchandise trade continued against Japan, it was on the way to betterment, and the balance of all payments was about even, due to large invisible items in favor of Japan, including returns from shipping and insurance, investments in Manchuria and China, and remittances from Japanese emigrants living abroad. Substantial balances had begun to accumulate in New York and London, and with the yen once more restored nearly to normal, the Government and important financial leaders felt the time was again favorable for the return to the gold standard.

Suzuki & Company

Before taking this final step, however, it was deemed necessary to make certain adjustments to put the domestic situation on a more satisfactory basis. It is here that the firm of Suzuki & Company comes into the picture. This was one of the firms which was originally in difficulties in 1920, and which had large obligations still outstanding at the time of the earthquake, the largest share of which was being carried by the Bank of Taiwan. The Government made strenuous efforts to put the affairs of the Bank of Taiwan in order, but was unable to make satisfactory headway.

Including sums owed by Suzuki & Company to the Bank of Taiwan and others, the total amount of bills outstanding as result of the earthquake amounted early this year to approximately 207,000,000 yen. Originally the amount of these bills was approximately 400,000,000 yen, but about half was paid off during the last three years, leaving the balance of 207,000,000 yen. As the original law under which the Bank of Japan was to be indemnified against losses due to discounting earthquake bills ran for one year only, it had to be renewed each year, and as the next date of expiration falls in September, 1927, it was necessary to decide whether to merely renew this arrangement or to set up some new and more systematic plan for carrying and gradually reducing these bills. The Government decided to take the latter course.

The Government's Proposals

In March this year the Japanese Parliament passed two bills providing for an issue of 5 per cent Government bonds to the aggregate sum of 207,000,000 yen, of which 100,000,000 was to be available to indemnify the Bank of Japan for any losses incurred under the old bill, and the remainder would be lent to the banks carrying earthquake notes for use as collateral for further loans at the Bank of Japan. These bonds were to run for ten years, but were to be reduced one-tenth each year.

The measure met sharp opposition, however, in Parliament. Inasmuch as a substantial part of the 207,000,000 yen earthquake bills still outstanding represented losses of Suzuki & Company, the opposition made the point that public funds should not be used to support this private concern which was the victim of its own over-trading. In the controversy thus arising, the weak points of the situation were revealed to the public. The people realized the unsatisfactory conditions prevailing and runs were started against weak banks, some six or seven being obliged to close during the period of the debate in March.

Affairs Reach a Crisis

When the House of Peers passed the bill just referred to they attached a condition that the Bank of Taiwan should be reorganized on a sounder basis and for that purpose a special committee composed of selected financial leaders of the empire and representatives of the various political parties was appointed by the Government. This committee submitted a plan, but before action could be taken, withdrawals of deposits from the Bank of Taiwan, which had been going on steadily, became heavy, and it was evident that if the bank could not get support from the Government it would have to close. In this emergency the Government proposed to support the bank to the extent of 200,000,000 yen, and as Parliament was no longer in session submitted this plan in the form of an emergency edict to the Privy Council for approval, as required by the constitution. Here political forces again came into play and the Privy Council rejected the bill on grounds that to propose a bill to the Privy Council without prolonging the regular session of the Parliament which had just ended was against the spirit of the constitution. This action of the Privy Council, while it might be correct technically, ignored the critical nature of the existing situation. Public uneasiness, which had been gradually increasing, flared up into general alarm on the announcement that the plan for supporting the Bank of Taiwan had been disapproved, and runs on banks became wide-spread, necessitating the declaration of a two-day bank holiday

over Friday and Saturday, and of a partial moratorium extending over three weeks.

Remedial Measures

On April 18, following action by the Privy Council, the Government resigned and a new cabinet was formed by the Opposition with Mr. Takahashi as Finance Minister. Mr. Takahashi has twice held his post in the past, is a former President of the Yokohama Specie Bank, has been once Governor of the Bank of Japan, and once Premier. He is especially known in the United States as Japanese Financial Commissioner who negotiated the first large Japanese loan in the United States during the Russo-Japanese war. On May 3 a special session of Parliament will convene, when the new Government is expected to submit another compensation bill similar to the one submitted by the former Cabinet to the Privy Council. The amount of the guarantee, however, will be increased to 500,000,000 yen.

Meantime the Bank of Japan has been extending credit freely to all banks which can supply security acceptable under the law.

The Worst Over

It is confidently expected that the measures which have been adopted, or are in prospect, will be adequate to meet the situation. While a moratorium has been declared, it applies only to deposits made prior to its declaration. Funds deposited since the moratorium may be freely drawn against. Confidence is being gradually restored, deposits are beginning to come back to the banks, and advances by the Bank of Japan have shown a considerable reduction since the peak.

The Bank of Taiwan continues closed in Japan, but a statement has been made that it will be reopened before the moratorium expires. Offices in Formosa and foreign branches, however, have remained open throughout the period. So far as the foreign branches are concerned, it can be said positively that they are in good shape, so that foreign markets are amply secured against losses.

1920 and 1927

The fact that the world-wide collapse of war inflation in 1920 began with an economic crisis in Japan and then spread to other markets of the world has led to some speculation as to whether the present disturbances in Japan might have similar consequences. There is no analogy, however, between 1920 and 1927. In 1920 prices were on a highly inflated basis all over the world, credits were everywhere strained, and money conditions tightening. In 1927 conditions are the opposite of this. Prices all over the world have been declining steadily for the past two years, offering little incentive to over-expansion. Bank reserves have been increasing and money rates falling. Just as our domestic business situation has been safeguarded by the absence of price inflation and existence of ample bank reserves, for the same reasons business the world over is vastly less likely to be disturbed by unsettlement in any one quarter than it was in 1920.

The policy which the Japanese Government has determined upon doubtless is the proper one for dealing with this emergency. It does not represent an effort to maintain prices in Japan above the level of prices in world markets, and reports indicate that prices in Japan have not been seriously disturbed by recent developments. The aim is to restore general confidence in order that business may proceed in an orderly manner. The amount of credit involved and of possible losses is so large that only the Government could deal with the situation effectively, and the general interest is great enough to justify its interposition. The lesson of the crisis would be lost, however, in Japan and elsewhere without recognition of the truth that the fundamental cause of these troubles has been a widespread effort to do too large a volume of business on too small an amount of capital.

While the circumstances which have precipitated the present crisis in Japan are very much regretted, it is believed that once normal conditions are restored the financial situation there will be on a very much sounder basis than in the past. Weak spots will have been cleaned out, and those banks which have stood the test will be all the stronger for it. Bankers in this country and elsewhere have entire confidence in the ability of the Japanese people to deal successfully with the situation.

A Statement by the New Finance Minister of Japan

Mr. Takahashi, formerly Prime Minister of Japan, who, while in retirement from public life, has now responded to the call of the nation to accept the post of Minister of Finance in view of the grave financial situation confronting Japan, has courteously granted an interview to an officer of this bank now in Japan, and given him an outline of the measures by which the government will ensure the restoration of normal conditions.

According to the Minister of Finance, the recent financial crisis was entirely due to a temporary suspension of confidence among the public. The economic and financial structure of Japan is fundamentally sound. If confidence is once restored the business world will resume its normal course. This being the salient feature of the situation, Mr. Takahashi, availing himself of the short breathing space afforded by the bank holidays and moratorium, has drawn up a plan by which he hopes to

reassure the public and restore normal conditions.

The essential feature of the measure is to protect depositors by replenishing the reserve funds of banks against continued withdrawal of deposits. This will be done by authorizing the Bank of Japan to make special advances to the banks for this purpose regardless of usual practices, under, of course, the control of the Minister of Finance. Any loss to be incurred by the Bank of Japan through special advances is to be borne by the state up to the limit of 500,000,000 yen and a special committee is to be set up for the determination of the said loss.

This measure, Mr. Takahashi is confident, will enable the nation to turn the corner and will lead to a real consolidation and adjustment of the financial and economic fabric of Japan.

European Affairs

It must be considered that political and economic conditions in Europe are alike more encouraging than they were at this time last year. The failure to admit Germany to the League of Nations at the Spring meeting in 1926, after arrangements were thought to be completed, seemed at the time to almost undo the good work at Locarno, but the disappointment tested the sincerity of all parties and in the end apparently tended to strengthen their mutual confidence. Dr. Stresemann, the German Foreign Minister, presided at the recent meeting of the League Council and contributed by his conciliatory attitude to a number of settlements in which he and M. Briand were the chief negotiators. Both of these ministers have given convincing evidence of a desire to promote good relations between their countries, and while each has had to undergo some criticism at home for his disposition to make concessions, on the whole they have been well supported. There is reason to believe that the business elements of both countries are anxious to have more international trade and less international politics.

Europe has not been free from alarms, for the relations between Italy and France and Italy and Jugoslavia have had enough prominence in the newspapers to make them subjects of concern. The irritation which for a time existed between the first two has subsided, and while the second situation has in it elements of a serious disagreement over Albania, it is believed that a conciliatory spirit will hold sway.

Government Finances

The financial status of the governments of Europe is in marked contrast to what it was a few years ago, and decidedly better than even a year ago. Excepting a few chronic cases of delinquency the treasuries are working on balanced budgets, and the currency situation has undergone a great change for the better. Last year at this time the currencies of Belgium, France and Italy were all sinking in value, with the first two in a bad state of demoralization, and trade throughout Europe was seriously affected. Belgium has accomplished definite stabilization with the value of the currency at approximately the level prevailing when the policy was adopted. France and Italy have each obtained such a degree of control over the situation as to stop depreciation and restore confidence in the currencies, but neither has been satisfied to effect stabilization at the levels of a year ago. From around 3 cents at that time the franc has been raised to about 4 cents and the lira from about 4 cents to above 5 cents. Much was said when these currencies were declining about the necessary value-relationships between them, but the governments have been influenced but little by that theory, and while some ill effects have been evident from the rising value of their currencies and the disparity between them, the public in both countries appears to have adapted itself to the changes with difficulties less serious than had been anticipated.

The French Floating Debt

The French Government has continued to improve its position with the Bank of France and in the short term money market by reducing the debt to the Bank and refunding the maturing obligations in the market into longer terms. The debt to the Bank was largely increased during the period when the currency was falling and the state of public alarm was making it impossible for the Treasury to float new issues fast enough to meet the rapidly recurring maturities. Now the situation is reversed, money pouring into the Treasury for its offerings so fast that between August 1st and the first of March, the Treasury was able to reduce its debt to the Bank from 37,400,000,000 francs, to approximately 29,600,000,000. The Treasury has ceased the issue of National Defence bonds, the principal element in the floating debt, for terms less than one year.

The budget of 1926 is not yet closed, but an authoritative estimate places the probable surplus at 1,000,000,000 francs. This is the first budget surplus since the war. The budget for 1927 has been passed, and is expected to also realize a surplus, but inevitably this will be to some extent dependent upon economic conditions during the year and their influence upon the revenues. Thus far the results are ahead of the estimates, despite a slowing down of industry in the first quarter of the year, which is now thought to have run its course.

The restoration of confidence has caused a large inflow of funds from abroad, for the most

part, no doubt, representing French capital which had gone out of the country for safety during the troubled days. This influx has given the Bank a great supply of foreign exchange, which as a reserve against an adverse balance of foreign payments is as good as gold. On the strength of this accumulation, the Bank of France during the past month arranged to pay off completely the remainder of a large war loan at the Bank of England, this transaction calling for approximately £33,000,000.

As security for the loan the Bank of France had deposited gold valued at £18,350,000 (a little less than $89,000,000) with the Bank of England, which sum in view of its character as a pledge is understood to have been not included in the reserve figures of the latter institution. The transaction is important as releasing a large sum of gold which has been immobilized and strengthening the reserves of the Bank of France by approximately 460,000,000 gold francs. It serves the Bank of England by converting a loan of indefinite duration into liquid assets. Whether or not it increases the amount of credit available in the London market would seem to depend upon the source from which the Bank of France is obtaining the funds by which the payment is made. If, as is probable, these funds have been employed in the London market for some time, the situation there would not be materially changed. The Bank of France since the war has been carrying the sum of 1,864,320,907 gold francs in its statements as "gold holdings abroad," of which no doubt the amount now returned has been a part. The status of these holdings never has been clearly understood by the public.

The influx of funds naturally has had the effect of producing a state of ease in the French money market. The official discount rate of the Bank of France, which stood at 7½ per cent on August 2, 1926, was reduced on December 16 to 6½ per cent, on February 3, 1927 to 5½ and on April 14 to 5 per cent. The rate on advances against securities, which as late as December was 9½ per cent, has been reduced to 6 per cent.

The Italian Situation

The Italian government has been proceeding successfully with the plan for the conversion of its floating debt into a long term loan. This policy was adopted last Fall as a necessary complement to the general policy of reducing the volume of the currency and raising its value. Inevitably the money situation tightened and the Treasury found difficulty in replacing the floating debt fast enough to provide the funds for meeting the maturities. In order to deal with the situation effectively the Government deemed it necessary to bring out a conversion loan consolidating the various short term issues up to a maturity of five years, and to make conversion compulsory upon all holders, at the same time offering terms for the conversion of longer term issues and inviting cash subscriptions from the public. The Littorio loan, as it is called, was offered to the public with an appeal to patriotism, as a measure necessary to place the Treasury in sound financial condition, and the response has been remarkable. In it will be consolidated about 22,000,000,000 lire of Treasury bonds, of which a little above 16,000,000,000 had maturities of one year or under, more than 1,500,000,000 a maturity of five years, 4,000,000,000 a maturity of seven years, and an undetermined amount having a maturity of nine years. The most extraordinary feature of the whole transaction, however, consists of the subscriptions by the public of new money, aggregating 3,400,000,000 lire, offered by approximately 3,000,000 persons. When it is understood that the loan draws only 5 per cent interest, while current interest rates are much higher and the outstanding 5 per cent issues now being converted have been selling under par, it will be appreciated that these cash subscriptions have the significance of a popular tribute to the Government and a tangible pledge of support.

Treasury receipts for the current year are exceeding expenditures by more than the budget estimate, and the excess of imports over exports is slightly less than last year. These conditions are better than might be expected in view of the contraction of credit, rising value of the currency in the exchanges and general decline of prices, which inevitably have a depressing influence upon business. The lira, which sold as low as 3.16 cents last year, has sold recently above 5½ cents, then reacting slightly below this figure. The Government's avowed policy has been that of favoring a gradual appreciation of the currency, Count Volpi in a recent speech stating its position as follows:

> The Government remains faithful to the program, already announced more than once, of cautious but systematic reduction of the currency circulation, more especially of that issued on behalf of the State, which will be gradually carried out by enforcing the measures decided on during these recent months.
>
> The stages of this reduction must not be reckoned over monthly or other brief periods, but over periods of not less than half a year, and while results will show that the tendency is strictly adhered to, the necessary elasticity to meet seasonal needs will be maintained.
>
> The whole of the Italian people has greeted with satisfaction the progress made with the revaluation of the lira, closely connected with the equalization of home prices with those expressed in appreciated value. The Government repeats that it considers this progress, which has been attained by purely objective means, as satisfactory.
>
> The course of the lira as expressed in gold exchange, more especially in terms of the dollar which has a steady gold value, has had nothing remarkable during the past months. Prices on the home market, which in September had reached the index number of 682.8, have been steadily declining, and in the last

week in January the index number stood at 600, equivalent to a gold parity of 133.59, as compared to the American index number of 145 and the British of 137.1.

It may be presumed that the rapid fluctuations of Italian exchange in recent weeks have not been a part of the Government's plan, but due to outside influences. Other instances might be named, of occurrences in recent years, where the plans of governments for gradually advancing the value of their currency have been anticipated and more or less embarrassed by speculative operations in the market. The recent foreign loans of Italian cities would naturally give sentimental support to the lira, although it is probable that the conversion of the proceeds of these loans will be spread over a considerable time.

The Gold Standard in Europe

Although the currencies of France and Italy have not been finally fixed in terms of gold, their status is so much improved that there is warrant for saying that Europe is nearing the re-establishment of relations on the gold basis. Denmark resumed gold payments on the first of the year on a bullion basis similar to that under which the Bank of England is working, and while Norway has not taken the final step, her currency is only slightly below par and she has gone through practically all the stress of deflation.

The significance of all this reconstruction of monetary systems is that Europe has nearly regained a uniform price basis, an essential condition of trade revival. It cannot be said that all the necessary wage and price adjustments have been made, for the process of bringing the various branches of industry and the industries of the different countries into normal relations is a slow one. Especially is this true as between the so-called "sheltered" and "unsheltered" industries—terms used to distinguish between industries whose wage and price-fixing conditions are mainly domestic and those which directly feel the force of foreign competition. With all currencies based upon gold the adjustments will be made more rapidly.

The Position of Great Britain

The great miners' strike in England began just a year ago, and for a few days was supported by a general strike, which made it look like a formidable challenge to constitutional government. It soon appeared, however, that the most important labor leaders of that country had no intention of attempting to establish Sovietism, and their conservative attitude in this crisis was one of the most important developments of the year in Europe.

The coal strike was a very costly dispute to Great Britain, affecting all the important industries to a serious extent, and that the results in the aggregate were not more disastrous is proof of the variety of British resources and the country's great reserves of strength.

A debate has been going on for several years over the sum of "invisible" credits accruing to Great Britain on account of investments and services abroad. The official calculations have indicated a safe balance of credits over debits in the series of recent unfavorable years, but such calculations necessarily have a large element of uncertainty in them. The trade disturbance caused by the strike, coming so soon after the resumption of gold payments and when so many factors in the world situation were uncertain, could not but cause uneasiness, but the steadiness of the London money money market throughout the past year, without resort to the special credits which were at its command, have indicated that the invisible credits had not been overestimated.

London banks have been loaned up closely, and the money market has been firm, but the gold holdings of the Bank of England increased from £150,500,000 on March 30 to £154,200,000 on April 27, easing the situation materially and prompting a reduction of the discount rate. The large debt payment by the Bank of France is reflected in the April 27 statement by a reduction of £26,624,000 in "loans on other securities," an important item of liquidation. As a result of these changes the reserve rose to 33.45 per cent, the highest figures touched since the war.

The Treasury receipts for the fiscal year ended March 31 naturally were seriously affected by the strike, and the budget shows a deficit, but it appears in the budgeted payment of approximately $300,000,000 to the sinking fund. Current expenses were fully covered, but debt reduction was only about $117,000,000, instead of the amount contemplated. The Chancellor of the Exchequer has added a few new taxes in this year's budget to make up the arrears to the sinking fund.

A Year of Recovery in Germany

The strike losses of Great Britain meant substantial gains on the continent. The coal and iron industries were directly helped by the absence of British competition, and the general industrial and business situation was stimulated. Belgium, Germany and Poland especially felt the effects and France shared in them. At the beginning of the strike, coal stocks in the Ruhr were heavy and production light, but the year ended with a total production in the Ruhr of 112,000,000 metric tons, which compares with 104,000,000 in 1925, 94,000,000 in 1924 and 114,500,000 in 1913.

Business conditions in Germany at the beginning of 1926 were decidedly bad. During the period of inflation, when profits were made

by rising prices, a great expansion of the business organization occurred, and in the latter part of 1925 and fore part of 1926 the inevitable readjustments to a more economical and efficient system were being made. Bankruptcies were numerous, consolidations were being arranged, economies put into effect. The working capital of the country had been largely wiped out, enterprise was restricted for lack of capital, and at the peak of unemployment approximately 2,000,000 persons were receiving public aid.

The benefits of international cooperation through the capital market have been strikingly demonstrated in Germany. Foreign loans gave the first relief, but within the past year evidence has been abundant that domestic accumulation was becoming important. Savings bank deposits increased from 1,629,000,000 reichsmarks at the end of 1925 to above 3,000,000,000 reichsmarks at the end of 1926, and there has been a steady increase of flotations in the domestic security market, at declining interest rates. The credits arising from foreign loans have supplied the Reichsbank with the means of largely increasing its gold reserves, thus enabling it to increase in still greater proportion its accommodations to the domestic banks, with the result that rates on commercial paper are approaching the pre-war level. The Reichsbank bill rate, which was 9 per cent at the beginning of 1926, is now 5 per cent, but the rate on collateral loans is 7 per cent. Mortgage loans and corporate bond issues have shared in the general decline of rates, but are not as near to the pre-war level as is commercial paper.

While the British coal strike was an important factor in the industrial revival it was not the only influence, and the increase in the domestic consumption of coal has been such that a return of the former state of depression the coal industry, as the result of British resumption, is not indicated. The leading industries now are in a good state of activity, but railroad traffic indicates that production has not fully attained the pre-war rate. It is not easy to see how this is possible until world trade has made a more complete recovery, and particularly until trade relations are more favorable with eastern Europe, including Russia, which was very important territory to Germany before the war.

German Reparation Payments

The volume of German exports has been increasing, but has not reached the pre-war figures, nor has the total for a full year, exclusive of payments in kind on reparation account, shown an excess over imports. These payments in kind are not included in the official trade statements, since they are not a part of the ordinary trade and do not create foreign exchange. Undoubtedly, however, deliveries in kind tend to reduce the regular exports. In the calendar year 1926 the official figures of merchandise imports and exports show an import balance of 132,000,000 marks, and for the twelve months of the annuity year ended August 31, 1926, a balance of 178,800,000 marks, while the report of the Agent-General for Reparation Payments for that annuity year shows deliveries in kind amounting to 655,929,000 marks. If these are added to the reported exports, the excess of all exports over imports would be 477,000,000 marks.

The sum of reparation payments due in the second annuity year was 1,220,000,000 marks, plus certain sums which brought the total to 1,269,503,041.53. Deliveries in kind, plus payments for armies of occupation, inter-allied commissions, and other payments in the mark currency, aggregated 760,199,635.09 marks, and the total actually transferred in foreign currencies aggregated 415,677,331.63, leaving a balance of cash unexpended on August 31, 1926, of 93,626,074.81 marks.

These figures are interesting as bearing upon the much-discussed problem of transfer. The several sources contributing to the reparation payments in that year were amply able to meet their quotas, but the surplus of merchandise exports over imports, including deliveries in kind, were not sufficient to cover the payments due abroad. While Germany doubtless has "invisible" items of income from abroad they probably do not equal her debit items of that class, and it seems to be a necessary conclusion that the payments in foreign currencies or exchange were made possible by the foreign loans.

Relation of Loans to Reparations

This is the basis of the statement frequently made that Germany is making the reparation payments in part at least by borrowing, but this is not a complete statement of the facts. As stated above, the sums required for the payments were raised by various levies within Germany, but the facilities for making payments abroad were not equal to the task of transfer without resorting to the foreign exchange created by loans. The proceeds of the loans were conveyed by the borrowing corporations to the Reichsbank in exchange for German currency, and the Reichsbank supplied the Agent-General with the amount of exchange which he required, taking pay in mark currency, from the reparations fund. It is clear that part of the proceeds of the German loans were used in reparation payments, but apparently this was only an exchange of funds, and if it be true that the full equivalent of the loans has gone into capital investments in Germany it is hardly correct to say in the sense

implied that the foreign loans were partly devoted to reparation payments. Germany has made the reparation payments and still has the proceeds of the loans in permanent form. Moreover, there is an abundance of evidence that Germany is making economic progress.

Nevertheless, the loans were necessary to the transfer, in the absence of larger exports. The situation illustrates the premises clearly laid down by the Dawes Committee, that the reparations problem consists of two parts: (1) the collection of the sums agreed upon within Germany; (2) the transfer of such sums to the creditor governments. The first condition is being met, but the exports of Germany are not yet sufficient to meet the second condition.

Increase of Payments in 1926-27 Annuity Year

That the first condition is being amply met is shown by the supplemental agreement by which the payments will be increased this year above the sum originally fixed. The Agent-General's report (p. 4) explains this arrangement as follows:

> **Under the terms of the Experts' Plan, the German budget was to contribute 110 million gold marks for the third Annuity year, and 500 million gold marks for the fourth Annuity year. At the same time, however, the Plan and the London Agreement provided that these budgetary contributions should be subject to modification by amounts not to exceed 250 million gold marks for each year, depending on the yield of the controlled revenues. If the aggregate yield of the controlled revenues were to exceed or fall short of 1,000 million gold marks during the Annuity year 1926-27, or 1,250 million gold marks during the Annuity year 1927-28, the budget contributions of the next succeeding years, respectively, were to be increased, or reduced, as the case might be, by an amount equivalent to one-third of the excess or deficit in the controlled revenues, but not to exceed 250 million gold marks for either year. In actual experience, the aggregate yield of the controlled revenues during the first Annuity year (1924-25), had amounted to 1,706 million reichsmarks, and the estimates already indicated for the second Annuity year (1925-26), aggregate returns of over 1,900 million reichsmarks. On this basis, the yield from the controlled revenues in the third and fourth Annuity years was likely to bring the contingency into operation, and to make the German budget liable, in all probability for supplemental contributions on account of both years. The new agreement, which was executed by the German Government and the Reparation Commission early in September, 1926, replaces the two contingent annual contributions with a single definite payment of 300 million gold marks, which Germany is to make during the third Annuity year.**

The total of payments due this year, therefore, will be 1,500,000,000 marks instead of 1,200,000,000 as fixed in the original plan, and the payments are being made. However, in the first six months of this annuity year, from September 1 to March 1, the excess of German imports over exports has been greater than in the corresponding period of last year, the explanation apparently being in an increased need for raw materials, due to greater activity of the industries and increased domestic consumption. Thus, the imports of cotton from the United States, from August 1st last to April 1st, 1927, were 2,346,541 bales, against 1,416,376 bales in that period of 1926.

No doubt Germany will find means of payment similar to those employed last year, but the second phase of the problem as described by the Dawes Committee remains in the third annuity year in the same obscurity in which it has been enveloped from the first. Financiers of all countries have explained over and over that in the last analysis large international payments can be made only in goods, but it is doubtful if many people even now comprehend why this is so. They do not grasp the fact that the domestic currency cannot be used for payments abroad and that the transfer of such sums in gold would break down the monetary system of the debtor country. Hence in the case of reparations, emphasis is continually laid upon ability to raise the required sums by taxation, instead of upon the problem of conveying the values from Germany to the creditor country.

The Dawes Committee evidently considered that difficulty probably would be experienced in making the transfers in the early years of the Plan's operations, pending the restoration of world trade to normal proportions and an increased demand for German products abroad. It provided exclusively against payment which would disturb the parity of exchange and required that unless payment could be made without so doing the funds should be allowed to accumulate in Germany up to the sum of 5 billion marks ($1,000,000,000). It is evident that such accumulations would have been necessary in the last year but for the supply of foreign exchange made available by the German loans abroad. Therefore, whatever difficulties may be experienced in effecting the transfers cannot be reasonably charged to the Plan; they are inherent in the situation and recognized in the Plan. It is a necessary part of the scheme that the creditor countries shall interest themselves in promoting the flow of German exports, at least until the natural flow is sufficient for the payments. German exports depend not only on the capacity of the German industries, but upon the willingness of other countries to receive German goods; furthermore, in the absence of sufficient exports transfers by means of foreign loans depend not only upon the willingness of Germans to borrow abroad, but upon the readiness of other countries to lend.

The Growth of National Income

Attention is invited to a striking exposition of one of the fundamental causes of our present good times in a recent study by the National Bureau of Economic Research on the national income. The American people, according to

the economists of the Bureau, had in 1926 an aggregate income of nearly 90 billion dollars, a record total, and an increase of approximately 27 billions, or 43 per cent, in the five years since 1921. Averaging over $2,000 for every person gainfully employed, this income indicates the highest standard of living for the population as a whole ever attained in this or any other country.

Year	Total Income (millions)	Income per person gainfully employed
1920	$74,158	$1,851
1921	62,736	1,537
1922	65,567	1,586
1923	76,769	1,821
1924	79,365	1,846
1925	86,461	1,971
1926	89,682	2,010

Nor is this great increase in income merely a fictitious quantity resulting from an increase in the price level, for the average price of direct or consumption goods was actually slightly less in 1926 than in 1921. Following is a table comparing income per person gainfully employed in both current dollars and in 1913 dollars which shows continuous gains since 1921 in both categories:

Income Per Person Gainfully Occupied

Year	Current Dollars	1913 Dollars	Year	Current Dollars	1913 Dollars
1909	$ 791	$ 823	1918	$1386	$879
1910	809	829	1919	1669	934
1911	812	821	1920	1851	907
1912	844	850	1921	1537	887
1913	864	864	1922	1586*	979*
1914	836	828	1923	1821*	1113*
1915	861	843	1924	1840*	1121*
1916	1014	919	1925	1971*	1163*
1917	1232	947	1926	2010*	1186*

* Preliminary estimate

It is this growth of income that has been the basis of America's huge buying power. It has been in evidence not only in the high rate of consumption, but also in the increase of national savings. Just how great these savings may be cannot be told, but the data given in the following table will give some idea of how rapid the rate of increase has been.

Objection may be made that new security issues cannot be included properly as evidence of savings by reason of the fact that they are often paid for by borrowing elsewhere, and to that extent represent merely an expansion of credit. It is true that some allowance has to be made for this, but there is plenty of evidence that a large part of the investment buying now going on does represent real saving. Moreover, further offsetting the element of credit increase in connection with new issues is the amount of savings represented in the purchase by large numbers of workers of stock in the companies for which they work, none of which is included in the usual statistics of savings.

EVIDENCE OF GROWTH IN NATIONAL SAVINGS
(In Millions of Dollars)

	Assets of Building & Loan Associations	Total Savings Deposits; June 30	Admitted Assets of Life Insurance Companies	New Security Issues (†)
1922	3,343	13,281	8,652	4,304
1923	3,943	15,180	9,455	4,304
1924	4,766	16,456	10,394	5,593
1925	5,509	18,086	11,538	6,224
1926	6,280	21,204	12,850(*)	6,311

(*) Estimated.
(†) New capital issues of corporate, foreign government, farm loan and municipality securities.

Inasmuch as the amount which the individual can spend on necessities such as food and clothing is fairly limited, the excess has flowed out and created the demand for better housing, for automobiles, radios and the like that has gone to sustain the business boom. It has also made possible a larger attendance at schools and colleges. Shortages created by the war may be made up and the stimulation to business derived from them dissipated, but the impetus received from an improving state of general well being goes on so long as each individual recognizes, and in his dealings with others is guided, by the principle that prosperity is dependent upon an even exchange of goods and services and that it is the wealth which each one produces that enables him to buy the products of others.

THE NATIONAL CITY BANK OF NEW YORK